No. 4[illegible]

In the Supreme Court of the United States

October Term, 1952.

ANNIE SAUDER, ADMINISTRATRIX OF THE ESTATE OF PHILIP SAUDER, DECEASED, ET AL., Petitioners,

vs.

MID-CONTINENT PETROLEUM CORPORATION, A CORPORATION, Respondent.

Response to Petition for Writ of Certiorari.

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IN THE SUPREME COURT OF THE UNITED STATES.

October Term, 1933.

No. 660

ANNIE SAUDER, ADMINISTRATRIX OF THE ESTATE OF PHILIP SAUDER, DECEASED, *ET AL.*, *Petitioners,*

vs.

MID-CONTINENT PETROLEUM CORPORATION, A CORPORATION, *Respondent.*

RESPONSE TO PETITION FOR WRIT OF *CERTIORARI:*

May It Please the Court:

This action was commenced in the District Court of Greenwood County, Kansas, by Phillip Sauder against the respondent, seeking the cancellation of the undeveloped portion of an oil and gas mining lease covering 360 acres of land in said Greenwood County. Subsequent to the removal of said case to the Federal Court Phillip Sauder died and the action was revived in the name of the petitioners herein, who are his sole and only heirs at law. The aforesaid lease was executed and delivered to respondent's predecessors in title on June 6, 1916, and contains the following provisions:

"That the said parties of the first part in consideration of the sum of $1.00 (One) Dollars, receipt of

which is hereby acknowledged to them duly paid by the said parties of the second part, and of the covenants and agreements hereinafter contained on the part of the said parties of the second part, to be kept and performed, do hereby lease and let unto the said parties of the second part the exclusive right for Ten Years from date hereof, *and as long thereafter as oil or gas can be procured thereon in paying quantities*, to enter upon, operate for and procure oil and gas upon the following described premises, situated in Greenwood County, State of Kansas, to-wit, East ½ of Sec. 16, Town. 23, Range 13, Acres 320. Southeast ¼ of Southwest ¼, Sec. 16, Town. 23, Range 13, Acres 40.

* * * * * * * *

"If oil or gas be found *on these premises* by said second parties, *all rights, benefits and obligations secured hereby* shall continue so long as either can be procured in paying quantities.

* * * * * * * *

"In case no well be commenced on said premises within one year from date hereof, all rights and obligations secured under this contract shall cease upon notice in writing from the said first parties. *Provided, however*, that the said second parties shall have the right to continue this lease in force from year to year, until a well is drilled thereon, by paying at any time within ten days from date of the service of said notice, an annual rental of $1.00 per acre for said premises. Said rental to be deposited to the credit of said first parties in Citizens State Bank in Gridley, Kansas, payable quarterly in advance." (R. 6-7)

The petitioners concede that during the primary term of the aforesaid lease, or in other words, during the first ten years after its execution, the respondent or its predecessors in title completed two wells upon the southwest 40 acres of said lease, that oil was discovered in paying quan-

tities in each of said wells, and that at all times since the completion of said wells they have produced oil in paying quantities and are still so producing. The first of said wells was completed on or about the 1st day of November, 1921, and the second on or about the 1st day of January, 1922. Other than the aforesaid wells there has been no development upon the leased premises (R. 17, 30).

Primary Question Involved Herein.

The primary question herein is whether, under the evidence and the lease sought to be cancelled, there was any implied obligation upon the part of respondent to drill an additional well or wells upon the leased premises.

Petitioners' Evidence.

The only evidence introduced by the petitioners is the map appearing at page 67 of the record, which map was prepared by the respondent, and which shows the location of the wells upon the land involved herein and upon the premises adjacent thereto, the date of the completion of each of said wells, the depth to which each of said wells was drilled and the initial production, if any, from each of said wells.

The petitioners introduced no evidence whatsoever that any of said wells on the adjoining properties produced oil or gas in paying quantities, that is, in sufficient quantities to repay the cost of drilling, equipping and operating said wells, together with a reasonable profit on the entire outlay, or that if respondent had drilled any additional well or wells upon the land involved herein it would probably have discovered oil or gas in paying quantities or that a

reasonably prudent oil operator would have drilled any additional well or wells upon the lands involved, or that any of the wells on adjoining properties had drained, was draining or was likely to drain any oil or gas from under the lands involved herein.

Respondent's Evidence.

George O. Moody, vice-president in charge of production of oil and gas for respondent, and who had been engaged in the oil and gas business for about 32 years, 16 years of which was in Kansas and Oklahoma, Lloyd Snyder, who had charge of the operation of the lease involved, and who had been production superintendent for the respondent in this particular locality for 13 years, L. J. Young, a graduate of geology at the University of Michigan, who had been employed as a geologist by the respondent for 10 years, and S. V. Brown, superintendent of the Shaffer-Howell Drilling Company, which owned the lease covering the Northwest Quarter (NW4) of Section 15, adjoining the lease involved on the east, and who had been superintendent of said company for 10 years, and had drilled all of the wells on the Northwest Quarter (NW4) of Section 15, with the exception of two, testified on behalf of the respondent, giving in detail their reasons therefor, that none of the wells on the premises adjoining the lease involved herein had drained, was draining or was likely to drain oil or gas from under the premises covered by said lease, that development on the premises involved herein and on the adjoining premises clearly indicated that if any additional well or wells had been drilled on the lease sought to be cancelled the same would probably not have produced oil or gas in paying quan-

tities, or in other words, in sufficient quantities to have repaid the cost of drilling, equipping and operating such well or wells, together with a reasonable profit on the entire outlay, and that a reasonably prudent operator would not have drilled any additional well or wells upon said lease (R. 48-65).

Mr. Moody also testified that the total revenue from oil produced from the lease involved from the time the two wells thereon were drilled to December 31, 1931, was $72,694.18; that the royalty paid to the lessors in said lease was between $9,000.00 and $10,000.00, that the total expenditures in connection with the development and operation of said lease was $46,464.97, and that said lease had shown a profit to the respondent of only approximately 5.1% per annum, which was a very small return for an oil venture, considering the large expenditures required and the great hazards involved (R. 48).

It was stipulated by the parties that the total of the 1/8th royalty paid by respondent under the lease involved herein from 1927 to the date of trial was $760.50 for the year 1927, $658.45 for the year 1928, $623.90 for the year 1929, $495.45 for the year 1930, $239.23 for the year 1931, and for the year 1932, up to the date of trial an average of $21.00 or $22.00 per month (R. 46).

Mr. Moody further testified that respondent had never abandoned or intended to abandon any portion of its lease, and that if the future should prove it practical to drill another well on said lease respondent was ready, willing and able to drill it (R. 51).

Respondent's Contention.

Respondent contends that its lease does not impose upon it any implied obligation to drill an additional well or wells upon the leased premises, in the absence of an affirmative showing that, under all the existing circumstances, there was a reasonable probability that oil or gas, in paying quantities, would have been discovered therein, or that a reasonably prudent operator would have drilled such additional well or wells.

The leading case of *Brewster* v. *Lanyon Zinc Co.*, (8 C. C. A.) 140 Fed. 801, which is a Kansas case, involving a lease on lands situated in Allen County, Kansas, sets forth clearly the tests for determining whether a breach of an implied covenant to drill oil or gas wells has been committed. In that case, as in the case at bar, the court was considering an implied covenant to continue exploration and development after the expiration of the fixed period of development, during which oil or gas had been found to exist in paying quantities. In said case Mr. Justice VAN DEVANTER, delivering the opinion of the court, said:

> "Considering the migratory nature of oil and gas, and the danger of their being drawn off through wells on other lands if the field should become fully developed, all of which must have been in the minds of the parties, it is manifest that the terms of the lease contemplated action and diligence on the part of the lessee. There could not well have been an express stipulation as to the number of wells to be drilled, as to when the wells, other than the first, should be drilled, or as to the rate at which the production therefrom should proceed, because these matters would depend in large measure upon future conditions, which could not be anticipated with certainty, such as the

extent to which oil and gas, one or both, could be produced from the premises, as indicated by the first well and any others in the vicinity, the existence of a local market or demand therefor or the means of transporting them to a market, and the presence of wells on adjacent lands capable of diminishing or exhausting the supply in the natural reservoir. The subject was, therefore, rationally left to the implication, necessarily arising in the absence of express stipulation, that the further prosecution of the work should be along such lines as would be reasonably calculated to effectuate the controlling intention of the parties as manifested in the lease, which was to make the extraction of oil and gas from the premises of mutual advantage and profit. * * *"

"But, while this is so, no breach can occur save where the absence of such diligence is both certain and substantial in view of the actual circumstances at the time, as distinguished from mere expectations on the part of the lessor and conjecture on the part of mining enthusiasts. The large expense incident to the work of exploration and development, and the fact that the lessee must bear the loss if the operations are not successful, require that he proceed with due regard to his own interests, as well as those of the lessor. No obligation rests on him to carry the operations beyond the point where they will be profitable to him, even if some benefit to the lessor will result from them. It is only to the end that the oil and gas shall be extracted with benefit or profit to both that reasonable diligence is required. Whether or not in any particular instance such diligence is exercised depends upon a variety of circumstances, such as the quantity of oil and gas capable of being produced from the premises, as indicated by prior exploration and development, the local market or demand therefor or the means of transporting them to market, the extent and results of the operations, if any, on adjacent lands, the character of the

natural reservoir—whether such as to permit the drainage of a large area by each well—and the usages of the business. Whatever, in the circumstances, would be reasonably expected of operators of ordinary prudence, having regard to the interests of both lessor and lessee, is what is required. A plain and substantial disregard of this requirement constitutes a breach of the covenants for the exercise of reasonable diligence, which, as before shown, is also made a condition of the lease under consideration."

The *Brewster* case was decided in 1905, approximately eleven years before the execution of the lease involved in the case at bar. Since that time it has been repeatedly cited and followed in Kansas and elsewhere. Probably no other decision involving oil and gas law has been cited so frequently. Even Judge McDermott in his dissenting opinion herein is forced to admit that it "is undoubtedly the leading case on the subject of implied covenants diligently to explore and develop." Strangely enough, considering his conclusions herein, Judge McDermott also said: "As I read the decisions of the Kansas Court, they adhere to the same general test as announced in *Brewster* v. *Lanyon Zinc Co., supra*, and followed by our court in *Denker* v. *Mid-Continent Petroleum Corporation*, 56 F. (2d) 725."

At least three of the Kansas cases upon which the petitioners rely, to-wit: *Howerton* v. *Gas Co.*, 81 Kan. 553, 106 Pac. 47; *Alford* v. *Dennis*, 102 Kan. 403, 170 Pac. 1005; and *Webb* v. *Croft*, 120 Kan. 654, 244 Pac. 1033, cite and follow the *Brewster* case.

In *Webb* v. *Croft*, *supra*, the court said:

"Defendants contend that as they had kept the lease alive by drilling one well during the lease period

and had paid the accrued rentals and royalties, the court was not warranted in requiring further development, and that it therefore had read into the contract conditions not stipulated by the parties and had placed burdens on the defendants not contemplated by the contract. Leases of this kind contemplate exploration and development, and not the bottling up of land for speculative or other purposes or the postponement of reasonable development, nor yet the limiting of development to an extent merely to prevent a declaration of forfeiture. Although not expressly mentioned in the lease, there is an implied covenant or condition that there shall be reasonable development and such operation as will protect the interests of both lessor and the lessee. *Howerton* v. *Gas Co.*, 106 P. 47, 81 Kan. 553, 34 L. R. A. (n.s.) 34; *Id.*, 108 P. 813, 82 Kan. 367, 34 L. R. A. (n.s.) 46; *Alford* v. *Dennis*, 170 Pac. 1005, 102 Kan. 403; *Harris* v. *Ohio Oil Co.*, 48 N. E. 502, 57 Oh. St. 118. The lease is silent as to the number of wells that shall be drilled on the land, and in such a case there is an implication that there shall be reasonable development of the land *by drilling such number of wells as an ordinary prudent man would do under the circumstances, taking into consideration the results of the development and whether or not there was a sufficient production to warrant the continuance of exploration and drilling.*"

The *Brewster* case announces the universal rule on the question under consideration, and the following are a few of the illustrative cases: *Goodwin* v. *Std. Oil Co.*, (8. C. C. A.) 290 Fed. 92; *Humphreys Oil Co.* v. *Tatum*, (5 C. C. A.) 26 F. (2d) 882; *Orr* v. *Comar Oil Co.*, (10 C. C. A.) 46 F. (2d) 59; *Cosden Oil Co.* v. *Scarborough*, (5 C. C. A.) 55 F. (2d) 634; *Denker* v. *Mid-Continent Petroleum Corporation*, (10 C. C. A.) 56 F. (2d) 725; *Pelham Petroleum Co.* v. *North*, 78 Okl. 39, 188 Pac. 1069; *Franklin, et*

al., v. *Wigton*, 132 Okl. 236, 270 Pac. 1; *Robinson, et al.*, v. *Miracle, et al.*, 146 Okl. 31, 293 Pac. 211; *Gypsy Oil Co.* v. *Cover, et al.*, 78 Okl. 158, 189 Pac. 540, and *Empire Gas & Fuel Co.* v. *Haggard*, 152 Okl. 35, 3 P. (2d) 675.

Petitioners' Contention.

In its final analysis petitioners' contention is that the lease involved herein imposed upon respondent an implied obligation to drill an additional well or wells upon the leased premises, notwithstanding the uncontradicted evidence herein that there was no reasonable probability that oil or gas in paying quantities would have been discovered therein, and notwithstanding the uncontradicted evidence that no reasonably prudent operator would have drilled such additional well or wells. In short, their contention is not that respondent was required to reasonably develop but was required to unreasonably develop the premises herein.

None of the Kansas cases, whether decided prior or subsequent to the execution of the lease involved herein, except certain *obiter dictum* in *McCarney v. Freel*, 121 Kan. 189, 246 Pac. 500, conflicts with respondent's contention, but, if anything, they support the same.

In support of their contention that the Kansas cases are contrary to respondent's contention and the holding of the Circuit Court of Appeals herein the petitioners cite: *Mills* v. *Hartz*, 77 Kan. 218, 94 Pac. 142; *Howarton* v. *Kansas Natural Gas Co.*, 81 Kan. 553, 108 Pac. 813; *Culbertson* v. *Cement Co.*, 87 Kan. 529, 125 Pac. 81, and *Day* v. *Kansas City Pipe Line Co.*, 87 Kan. 617, 125 Pac. 43, all decided prior to the execution and delivery of the lease involved

herein; and *Alford* v. *Dennis*, 102 Kan. 403, 170 Pac. 1005; *Webb* v. *Croft*, 120 Kan. 654, 244 Pac. 1033; and *McCarney* v. *Freel*, 121 Kan. 189, 246 Pac. 500, decided subsequent to the execution and delivery of said lease. None of said cases, however, with the exception of certain *dictum* in *McCarney* v. *Freel, supra*, which was decided subsequent to the execution and delivery of the lease involved herein, supports petitioners' contention, but on the contrary all of said cases, with the exception of the aforesaid *dictum*, support the contention of the respondent and the holding of the Circuit Court of Appeals herein.

The Circuit Court of Appeals considered and reviewed the Kansas decisions, and after announcing the general rule with reference to the implied obligation of an oil and gas lessee to further develop, said:

> "This is the rule announced by the great weight of authority. *It has been approved by the Kansas decisions.* See *Webb* v. *Croft*, 120 Kan. 554, 244 Pac. 1033; *Howerton* v. *Kan. Nat. Gas Co.*, 81 Kan. 553, 106 Pac. 47; *Id.*, 82 Kan. 367, 108 Pac. 813; *Day* v. *Kansas City Pipe Line Co.*, 82 Kan. 861, 109 Pac. 186."

Mills v. *Hartz, supra*, was an action to cancel an oil and gas lease for a primary term of 20 years and as much longer as gas, coal and oil were found in paying quantities. Said lease contained no provision with reference to the commencement of a well on the leased premises. There was no development whatever upon said premises, and after a lapse of 7½ years the action was commenced to cancel said lease. There was no showing that it probably would not have been profitable to drill a well on said premises. The court simply held in said case that where an oil and gas lease con-

tains no provision with reference to the commencement of development there was an implied obligation to commence development within a reasonable time after the execution of the lease and that the failure to commence development was a practical abandonment of the lease. There was no question in said case of the extent of the development required after oil or gas was discovered in paying quantities or of the right of the lessee to hold all of the leased premises after the discovery of oil and gas thereon where the circumstances indicated that oil or gas in paying quantities could not be produced from additional wells. It, therefore, follows that said case is not an authority one way or the other in the case at bar.

In *Howerton* v. *Kansas Natural Gas Company, supra,* the lease involved was executed on the 20th day of November, 1902, and was for a period of 10 years and as long thereafter as oil or gas was produced in paying quantities. Within one year after the execution of said lease a gas well was drilled on the leased premises capable of producing gas in commercial quantities sufficient to justify the expense of marketing the same. Nevertheless no sale of gas was made from said well and gas was not used therefrom in any way except that the lessee used some for fuel to furnish power for the drilling of two wells on adjacent premises leased from other owners. There was no further development or operation on said premises, and on the 17th day of November, 1907, the lessor declared a forfeiture of the lease. Said lease provided that a well should be drilled thereon within one year and contained no provision for the payment of rentals for delay or failure to prosecute the work of development. There was no showing that gas could not be pro-

duced in paying quantities from additional wells, but the inference reasonably to be drawn from the opinion is that if additional wells had been drilled gas could have been produced therefrom in paying quantities. The lessee offered no excuse or justification whateyer for its failure to market the gas from the well drilled or for its failure to further develop the premises. The court in said case simply held that since the lessee was obligated to drill a well, it was further obligated to market the product of said well for the mutual benefit of the parties and that its failure to do so justified a forfeiture of the lease. While the opinion of the court states that the lessee was obligated to reasonably develop the premises, the court did not attempt to define "reasonable development," but it is clear that the court was of the impression that if additional wells had been drilled they would have produced in paying quantities. In the case at bar, as heretofore pointed out, the respondent was producing oil from the premises involved in paying quantities, and the uncontradicted evidence disclosed that oil could not have been found in paying quantities in any additional well or wells. Therefore, the aforesaid case is not an authority for the contention of petitioners.

The opinion in the *Howerton* case, *supra*, was withdrawn on rehearing and the case reversed and remanded for further proceedings, as appears from the opinion in 81 Kan. 553, 108 Pac. 813, and we earnestly insist that the opinion on rehearing in said case is an authority for the contention of the respondent. On said rehearing, the court held that the evidence did not disclose a right to have defendant's lease cancelled, but that the plaintiff was en-

titled to damages for the defendant's default. The court said:

> "The default consisted in the failure to properly develop the leased territory by drilling and operating a reasonable number of wells necessary for that purpose, and the failure to market gas and make the payments, stipulated for the well completed. *No reason is shown why witnesses of experience, acquainted with the gas field, may not testify with reasonable accuracy as to the number of wells which should have been drilled on the leased land both for protection from drainage by neighboring leaseholds and to obtain the gas underneath the land.* No insurmountable obstacle to such proof is perceived by the court, and, in the absence of evidence that it cannot be produced, it is concluded that the plaintiff is not entitled to a remedy by forfeiture or cancellation of the lease. * * *
>
> "It should be observed that this is not a case where royalties payable in a share of the product are provided for, but is an agreement to pay $50 per annum for each gas well. *The measure of damages therefore is the sum the plaintiff has lost or may lose by the failure of the defendant to complete the number of producing wells reasonably necessary to develop the resources of the leased land and to protect its lines.* * * *"

Culbertson v. Iola Portland Cement Co., supra, was an action for an accounting from the defendant for gas obtained and used by it from the plaintiff's land through wells on his land and through wells drilled by defendant on adjoining lands. It was alleged that there was a general pool of gas under plaintiff's land and that the defendant had drilled wells on adjoining premises and through them extracted gas from plaintiff's land. The evidence disclosed, and the referee to whom the case was referred found, that a large quantity of gas had been taken from said land, and the

court held that plaintiff was entitled to an accounting therefor, whether it was obtained from wells drilled on his land or from those drilled on adjacent premises. In its opinion the court said:

> "Since the number of wells to be drilled on the land was not specified, there was an implied obligation on appellants to fully develop the land and *put down as many wells as were necessary to secure to appellee his proportionate share of the pool of gas.*"

It clearly appears that the court was not of the opinion that the defendant was obligated in all events to drill additional wells on the plaintiff's land, but was required only to drill such number of wells as were necessary to secure to the plaintiff his proportionate share of the pool of gas which the evidence disclosed underlaid his land and was being drained therefrom through wells on adjoining lands.

Day v. *Kansas City Pipe Line Co., supra,* was an action to cancel the undeveloped portion of a 600-acre lease by reason of the failure of the lessee to properly develop. Said lease required the lessee to drill 4 wells within 6 months and "*to continue drilling as long as paying wells were found or royalties were paid.*" The original lessee drilled and completed 4 wells on 80 acres of said premises within the first 6 months after said lease was executed. No further development was had for approximately 4 years, when the plaintiff filed his original petition. Subsequent to the filing of said petition, the lessee drilled 4 additional wells on another 80 acres of said lease, which produced oil in paying quantities, leaving the remainder of the 600 acres undeveloped. The trial court found that the lessee had not

exercised reasonable diligence in developing the premises in accordance with the aforesaid provisions of the lease and cancelled the lease as to all of the leased premises except the aforesaid 160 acres. There was no evidence that if additional wells had been drilled on the remainder of said premises oil or gas could not have been discovered therein in paying quantities, but the court simply held that under the aforesaid clause of the lease requiring the lessee to continue drilling as long as paying wells were found or royalties were paid the lessee was expressly obligated to drill additional wells. In its opinion the court does not attempt to define "reasonable diligence" in any case, but says that "what is due diligence is a question of fact which has been decided adversely to the contention of appellant." Said case is, therefore, no authority that drilling and producing oil in paying quantities from the two wells involved in the case at bar was not due diligence, in view of the uncontradicted evidence that oil or gas could not have been produced in paying quantities from any additional well or wells on the premises involved. The statement by the court that if paying wells could not be found on the land, or any part of it, there was no reason why appellant's title should be longer clouded with a barren encumbrance or any reason why appellant should resist cancellation, was *obiter dictum,* and certainly not binding upon the federal court.

Alford v. *Dennis, supra,* was an action to cancel an oil and gas lease in so far as it covered 220 acres of land belonging to the plaintiff. The original lease covered a tract containing some 936 acres, consisting of one tract of 716 acres and another tract some 2 miles distant therefrom, being the 220 acre tract in question. Subsequent to

the execution of the lease the ownership of the two tracts was separated. Said lease was for a period of 10 years and as much longer as gas or oil was produced in paying quantities, and provided that the lessee should begin operations thereunder within 6 months from the delivery of the lease, and complete 3 wells on said premises, and that no other or additional expense should be incurred under said lease by the lessee. 25 wells were drilled on the larger tract and the lessee paid royalties to the then owners thereof, but never at any time during the 13 years between the execution of the lease and the commencement of the action did any drilling on the smaller tract. The petition disclosed that there had been three separate and distinct oil booms in the vicinity and prayed for a cancellation of the lease insofar as it covered the aforesaid 220 acres. The lessee's demurrer to said petition was sustained by the trial court, from which ruling the lessor appealed. The opinion of the court recites that it was improvident for the owner to grant a lease on two large tracts for a long term without any requirements of exploration and development, but that it was not the province of the court to end a contract merely because it was a bad bargain. The court further stated that the petition narrated a predicament capable of some legal or equitable redress, not necessarily the redress prayed for by the plaintiff, and held that the case should be reversed and remanded to the trial court with directions to permit the issues to be joined and the facts determined and to allow plaintiff damages if they could be definitely ascertained, and in the alternative that the lessee be required to proceed in good faith to develop the premises within a reasonable time. Said opinion does not disclose that it was improbable

that oil or gas could be produced on said premises in paying quantities, and it is reasonable to assume, in view of the fact that the court required further development, that it was of the opinion that if such development was made oil or gas in paying quantities could be discovered. We are certainly not justified in assuming that there was any showing in the case that oil or gas in paying quantities could not be discovered, or that the court would have ordered the defendant to perform apparently useless acts. The court did say that unless the plaintiff's tract was to be developed some time there was no reason to include it in the lease and that if the defendant had no bona fide intention to develop said tract to cancel the lease would do him no injury, but, as heretofore pointed out, the court refused to cancel said lease and said statement was *obiter dictum,* Said case is certainly no authority for the proposition that where there are producing wells on a lease and the evidence discloses that oil or gas probably would not be discovered in paying quantities on the remainder of the lease, the lessor is entitled to a cancellation as to the undeveloped portion of the lease.

Webb v. *Croft, supra,* was an action to cancel an oil and gas lease on several tracts of land, comprising 580 acres. The lease was for a term of 5 years and as long thereafter as oil or gas, or either of them, was produced therefrom. Said lease further provided that the lessee should complete a well within 12 months from the date of the lease or pay to the lessor $580.00 per year for each year drilling was delayed. There was no development until shortly prior to the expiration of the primary term of the lease, but a producing gas well was completed one day before the

expiration of the lease. The trial court found that the lease had not been sufficiently developed and decreed that there should be further development and provided in said decree what further development should be made and the time within which it should be made. From said decree the defendant appealed. The only justification offered by the defendant for its failure to drill any other or additional wells on the premises was that there was no market for more gas in the vicinity than was already being produced. There is no showing that oil or gas could not have been discovered in paying quantities had additional wells been drilled. Relying on and citing with approval *Howerton* v. *Kansas Natural Gas Company, supra,* and *Alford* v. *Dennis, supra,* the court said:

> "The lease is silent as to the number of wells that shall be drilled on the land, and in such a case there is an implication that there shall be reasonable development of the land *by drilling such number of wells as an ordinary prudent man would do under the circumstances, taking into consideration the results of the development and whether or not there was sufficient production to warrant the continuance of exploration and drilling.*"

Therefore, the forgoing case, rather than being an authority for the contention of the petitioners, is a direct authority for the contention of the respondent.

Clearly the court ordered further development under the justified assumption that oil or gas could be produced in paying quantities from additional wells.

McCarney v. *Freel, supra,* is the only Kansas case cited by the petitioners which is in the least contrary to the contention of the respondent. That case was an action to can-

cel on oil and gas mining lease which covered a quarter section of land, which said lease was for a term of 10 years and as much longer as oil or gas could be produced in paying quantities. Four months after the execution of the lease a well was drilled, which produced oil in paying quantities and continued to so produce until the time of the trial of said case. Five years thereafter a dry hole was drilled on said premises, and no further effort was made to develop the resources of the land. The trial court cancelled said lease, and, in affirming the action of the trial court, the Supreme Court said that the "plaintiff's evidence warranted the inference that defendants have not reasonably developed her land." Upon that theory alone the plaintiff was entitled to a cancellation of the lease on the undeveloped portion of the leased premises. The court, however, went on to say:

> "If the undeveloped portion of the land will not produce mineral in paying quantities, and the lessee would not be justified in drilling more wells, he may not continue to hold by virtue of a provision in the lease extending the term so long as oil or gas may be produced in paying quantities."

The opinion in said case covers less than a half page of the Pacific Reporter, and the court does not cite a single case in support of its conclusion. Said case is contrary to the prior Kansas decisions and directly contrary to the decision of the Kansas court in *Webb* v. *Croft, supra,* decided a few months prior to said case. We, therefore, earnestly insist that little or no weight should be attached to said case, and that since said case was decided long subsequent to the execution of the lease in the case at bar and is

contrary to the former decisions of the Kansas court, the decision in said case is not binding upon the federal court as establishing a rule of property.

Summarizing, none of the foregoing cases, with the exception of the *dictum* in *McCarney* v. *Freel, supra,* is authority for the petitioners' contention that there is an implied covenant in an oil and gas mining lease to further develop the premises under lease where the evidence discloses that oil or gas is being produced therefrom in paying quantities and further discloses that oil or gas could not be produced in paying quantities in any additional well or wells on said premises, and that no reasonably prudent operator would drill an additional well. On the contrary, said cases clearly establish that under a lease such as is involved in the case at bar the lessee is obligated to drill only such wells as a reasonably prudent operator would, under the circumstances, drill. It, therefore, follows that the decision of the Circuit Court of Appeals herein is not contrary to the Kansas decisions.

The Kansas cases require the plaintiff in an action to cancel an oil and gas lease for breach of an implied obligation to develop or further develop to show as a prerequisite to the right of cancellation that plaintiff's damages are not susceptible of measurement, and no such showing was made in the case at bar.

In the case of *Howerton* v. *Kansas Natural Gas Co.,* 81 Kan. 553, 108 Pac. 813, it was specifically held that in an action to cancel an oil and gas lease for failure to fully develop the leased premises the burden was upon the plaintiff to show that a remedy in damages was not an adequate

remedy and in the absence of such showing a decree for cancellation would not be sustained. In the case at ba no such showing was made or even attempted.

Contrary to petitioners' contention, an oil and gas lease in Kansas does not convey an interest in real estate.

In *Mills* v. *Hartz*, 27 Kan. 218, 94 Pac. 142, the court said:

> "*The lease is not a grant of land, nor of the oil, coal, or gas in the land.* It did not transfer any estate to Mills, and hence some of the rules which he invokes as to nonuser and abandonment do not apply. *Hartz granted him the possession of a part of the land with the right to search for minerals, and gave him an interest in so much of the minerals as might be found and taken out, but, if none were found, no interest in the undiscovered mineral could be acquired by him, and certainly no estate in the land.*"

In *Huston* v. *Cox*, 103 Kan. 73, 172 Pac. 992, cited by the petitioners, the court held:

> "A lease granting the right to enter on land and to explore for oil and gas, and if it be found in paying quantities to operate and produce, is not a lease in the strict sense, and creates no estate in the lands, but merely an 'incorporeal hereditament', which is a right growing out of, or concerning, or annexed to, a corporeal thing, but not the substance of the thing itself."

In *Robinson* v. *Smalley*, 102 Kan. 842, 171 Pac. 1155, cited by the petitioners, the court said:

> "While the court has held that an oil and gas lease of the kind under consideration does not constitute a conveyance, will not support a mechanic's lien, does not

operate as a grant and severance of mineral in place, *and creates no estate proper in the land itself*, it does create an incorporeal hereditament. A contract for the sale of hereditaments, whether incorporeal or corporeal, is within the sixth section of the statute of frauds. Gen. Stat. 1915, Sec. 4889."

In *Brinkman* v. *Empire Gas & Fuel Co.*, 120 Kan. 602, 245 Pac. 107, relied on by the petitioners, the court held:

"The grant was a grant of exclusive privilege for ten years to enter upon, operate for, and procure oil and gas on the described land—*a profit a' prendre.*"

Since none of the foregoing Kansas cases involved the precise facts involved in the case at bar, the Circuit Court of Appeals was not bound thereby.

As heretofore pointed out, in not a single one of the Kansas cases relied on by the petitioners did the evidence disclose that if additional wells had been drilled on the premises involved therein said wells would not have produced oil or gas in paying quantities, or that a reasonably prudent operator would not have drilled an additional well or wells thereon. Consequently, none of said cases involved the precise facts in the case at bar.

In *John Deere Plow Co.* v. *Mowry*, (6 C. C. A.) 222 Fed. 1, the court held:

"It is only to a settled rule of a state court applicable to the precise facts disclosed by the record that a federal court should yield its own judgment."

Since the lease involved herein was executed and the rights of the respondent accrued thereunder prior to the only Kansas case, to-wit: *McCarney v. Freel, supra,* which can be said to conflict with respondent's contention, the Circuit Court of Appeals was not required to follow said case.

The case of *McCarney* v. *Freel, supra,* was decided June 12, 1926, and the lease involved herein was executed on the 6th day of June, 1916.

In 25 Corpus Juris, at page 843, section 179, the following general rule is stated:

> "When contracts and transactions have been entered into and rights have accrued thereon under a particular state of the decisions, or when there has been no decision of the state tribunals, the federal courts will adopt their own interpretation of the law applicable to the case, although a different interpretation may be adopted by the state courts after such rights have accrued. * * *"

In the case of *Barton V. Kuhn* v. *Fairmont Coal Company,* 215 U. S. 348, 54 L. ed. 229, this court held as follows:

> "A decision of the highest state court that the grantor in a deed conveying the coal under a tract of land, with the right to excavate, and remove all of the coal, cannot maintain an action for damages in tort, founded upon the failure of the grantee or his successors to leave sufficient support to the overlying or surface land, is not binding upon the federal courts in a similar action based on almost identical facts and circumstances, the granting clause of the two deeds being in fact identical, where such decision was handed down after the deed upon which the defendant relies was executed, and after the injury complained of was sus-

tained, and the action begun, and where the point decided had not been previously adjudged by the state Supreme Court."

In the case of *Denker* v. *Mid-Continent Petroleum Corporation*, 56 F. (2d) 725 (10 C. C. A.), deciding the identical question involved herein, it was held:

> "Decisions construing oil leases decided after lease involved was executed *held* persuasive only."

In *Mothershead, State Bank Com'r of Oklahoma*, v. *United States Fidelity & Guaranty Co.*, 22 F. (2d) 644, (8 C. C. A.) it was held:

> "Decision rendered by the highest state court after rights and liabilities of parties under contracts involved in federal court suit have fully accrued is not binding on federal courts as a rule of decision."

In *Butte & Superior Copper Co.* v. *Clark-Montana Realty Co., et al.*, (9 C. C. A.) 248 Fed. 609, the court held:

> "Decisions of the Montana state court as to the validity of mining locations are not precedents binding on the federal courts in a suit involving the validity of locations in that state made prior to the rendition of such decisions of the Montana court."

The matter of construing an oil and gas lease is a matter of general law concerning which the federal courts will reach their own conclusion.

In the case of *Foxcroft* v. *Mallett*, 45 U. S. 353, 11 L. ed. 1008, this court held:

> "A decision of a state court upon the construction of a deed, as to matters and language belonging to the common law and not to any local statute, although entitled to high respect, is not conclusive upon this court."

Since the relief sought herein is wholly in equity, the Circuit Court of Appeals was not bound by any Kansas decisions.

The only question decided in the case at bar was whether the petitioners were entitled to the cancellation of the oil and gas lease involved herein by reason of the alleged failure of the respondent to properly comply with the implied covenants of said lease. This was purely an equitable question, depending for its decision upon the general principles of equity jurisprudence. And it is well established that federal courts are not bound to follow the decisions of state courts in cases depending upon general principles of equity jurisprudence.

In the case of *Lyon, et al.*, v. *Union Gas & Oil Co., et al.*, 274 Fed. 957, the United States District Court for the Eastern District of Kentucky held:

> "The decision of the state court that equity would enforce the forfeiture of an oil and gas lease for failure to develop after reasonable notice is one affecting the right to relief in equity, which is not binding on the federal court, especially where the decision was a *dictum*, and a statute had since been enacted establishing the contrary rule."

During the course of the opinion in said case, Judge Cochran said:

> "It seems to me that, if that doctrine is to prevail, it is decidedly questionable whether the notice given here was a reasonable one, only 3 months, and the lease contemplated an annual payment. It may be that, if that doctrine applies, there ought to be a year's notice. At any rate, the burden was on the plaintiff to show that that was a reasonable time, and it is extremely

doubtful, to say the least of it, whether or not they made out that a reasonable time had elapsed. However that may be, I do not think that I am controlled by the decision of the Kentucky Court of Appeals in the *Monarch* case. The Kentucky Court of Appeals has never actually applied that doctrine to a single solitary case. Never has a lease been forfeited by that court upon a notice requiring development. The statement of the Court of Appeals that a forfeiture can be brought about in this way is pure *dictum*. As stated, never yet has a case been decided by them where a lease has been declared forfeited upon a notice.

"Furthermore, I do not think that *dictum* is sound. According to the very terms of the lease, delay in development is authorized on the payment of the rental. For a court to forfeit a lease on failure to develop on notice is to change the contract of the parties. If the legislature were to pass a law saying or providing that in a lease of this character development might be hastened by giving notice, it would be in violation of the constitutional provisions that inhibits the legislature passing a law impairing the obligation of a contract. Then, in March, 1920, the legislature passed an act overthrowing that doctrine, saying that no lease could be forfeited in that way. So it is no longer a doctrine in Kentucky that a lease can be forfeited in that way. But I do not think that, if that statute had never been passed, I would be bound to follow that *dictum* of the Court of Appeals. All that is involved is a question of equitable relief. The Supreme Court of Illinois had held that it was not equitable to enforce a lease if if it had a surrender clause in it, and yet the Supreme Court of the United States, in the case of *Guffey* v. *Smith*, 237 U. S. 101, 35 Sup. Ct. 526, 59 L. ed. 856, decided that the federal court was not bound by that decision—that the federal court would enforce a lease containing a surrender clause—on the ground that it was a matter of relief in equity, and in a matter of that sort federal courts are not bound by state courts."

In the case of *Guffey* v. *Smith*, 237 U. S. 101, 59 L. ed. 856, Mr. Justice VAN DEVANTER, speaking for the court, said:

"The Supreme Court of Illinois, while fully sustaining the right to maintain such a suit in the courts of the state when the lease contains no clause giving the lessee an option to surrender it (*Gillespie* v. *Fulton Oil & Gas Co., supra*), holds that the presence of such a clause in the lease operates to prevent the lessee from directly or indirectly enforcing it in equity (*Watford Oil & Gas Co.* v. *Shipman*, 233 Ill. 9, 13, 14, 122 Am. St. Rep. 144, 84 N. E. 53, and *Ulrey* v. *Keith*, 237 Ill. 284, 298, 86 N. E. 696), the ground of distinction being that the surrender clause, although lawful in itself, and not affecting the validity of the lease, renders it so lacking in mutuality that equity will remit the lessee to his remedy at law. These decisions, it is insisted, should have been accepted and applied by the circuit court. To this we cannot assent. By the legislation of Congress and repeated decisions of this court it has long been settled that the remedies afforded and modes of proceeding pursued in the federal courts, sitting as courts of equity, are not determined by local laws or rules of decision, but by general principles, rules and usages of equity having uniform operation in those courts wherever sitting. Rev. Stat., Secs. 913, 917; Comp. Stat. 1913, Secs. 1536, 1543; *Neves* v. *Scott*, 13 How. 268, 272, 14 L. ed. 140, 142; *Payne* v. *Hook*, 7 Wall. 425, 430, 19 L. ed. 260; *Dodge* v. *Tulleys*, 144 U. S. 451, 457, 36 L. ed. 501, 503, 12 Sup. Ct. Rep. 728; *Mississippi Mills* v. *Cohn*, 150 U. S. 202, 204, 37 L. ed. 1052, 1053, 14 Sup. Ct. Rep. 75. As was said in the first of these cases: 'Whenever a case in equity may arise and be determined, under the judicial power of the United States, the same principles of equity must be applied to it, and it is for the courts of the United States, and for this court in the last resort, to decide what those

principles are, and to apply such of them to each particular case as they may find justly applicable'."

In the case of *City of Dallas* v. *Higginbotham-Bailey-Logan Co.*, 37 F. (2d) 513, the Circuit Court of Appeals for the Fifth Circuit held:

> "A federal court siting in equity is not bound by decisions of state courts."

If the Kansas decisions are in conflict by reason of *McCarney v. Freel, supra,* or are not clear and definite upon the precise question involved herein, the Circuit Court of Appeals was not required to follow said decisions.

The above proposition is fully sustained by the case of *Concordia Ins. Co.* v. *School Dist.*, 282 U. S. 545, 75 L. ed. 528, in which this court said:

> "The general rule that a federal court will follow the decisions of the highest court of a state construing a state statute is, of course, well established. The difficulty here is that, prior to the judgment of the federal district court in this case allowing interest, the decisions of the Supreme Court of Oklahoma were in such confusion that the view of that court in respect to the meaning of the statute, as applied to the present case, could not definitely be determined."

The Circuit Court of Appeals did not err in holding that the evidence in the record herein failed to show a breach of any implied obligation of respondent's lease.

The petitioners argue that the Circuit Court of Appeals, conceding it was right on the law announced in its opinion herein, reached the wrong conclusion as to the facts established by the evidence. A sufficient answer to this

argument is that the Circuit Court of Appeals, as its opinion clearly discloses, reviewed the evidence critically and in detail and arrived at the inevitable conclusion that the respondent had breached none of its implied obligations under the lease involved herein. Therefore, a review and argument of the evidence is, in our opinion, unnecessary. That the evidence clearly and without any conflict establishes that respondent had not abandoned any part of the leased premises, that there was no reasonable probability of oil or gas in paying quantities being discovered in any additional well or wells upon said premises, that no reasonably prudent operator would have drilled an additional well or wells, and that respondent stood ready, willing and able to further develop said premises to the extent that further developments indicated was practical, is beyond the realm of controversy.

Conclusion.

The lease herein specifically provides that in the event the lessee discovers oil or gas in paying quantities, upon the leased premises, within ten years from the lease date, it shall continue in full force and effect, upon the whole of said premises—not any particular part thereof—as long thereafter as oil or gas, in paying quantities, is produced thereunder by the lessee. To limit the continuance of such a lease after discovery of oil or gas to any specific portion of the leased premises—whether the same be forty or a thousand acres—is to disregard plain and unequivocal language. No objection is made to the cancellation of such a lease where there has been a breach of either an express or an implied obligation of the lessee. Here it is not claimed that the respondent has violated any of its express obliga-

tions. The claim is that it has breached an implied obligation of its lease. And what is that implied obligation? Petioners answer, the obligation to diligently and reasonably develop the leased premises. Well sounding words, but what do they mean? Certainly what is diligent and reasonable development does not depend solely upon lapse of time, or upon the amount of acreage covered by the particular lease, disregarding entirely the cost of the development, the prospects of discovering oil or gas, the cost of producing same, or the market therefor, to say nothing of other factors always considered by a reasonably prudent operator before deciding to commence a well. But that is exactly what the contention of petitioners reduces itself to, and they would have the court believe that the Kansas decisions support them. Surely it can not be said that the parties to an oil and gas lease ever contemplated that, notwithstanding the lessee had at great expense, discovered oil or gas in paying quantities and was producing same, he was required, in order to continue his lease as to the undeveloped portion of the leased premises, to keep drilling wells, in spite of the fact that there was no reasonable probability of discovering oil or gas therein, and in spite of the fact that no reasonably prudent operator would drill such wells. Instead of this being reasonable development it is the very opposite—unreasonable development. The implied obligation invoked by petitioners simply does not exist.

Respectfully submitted,

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